VZCZCXRO8830
RR RUEHDBU RUEHFL RUEHKW RUEHLA RUEHROV RUEHSR
DE RUEHSK #0037/01 0161219
ZNY CCCCC ZZH
R 161219Z JAN 07
FM AMEMBASSY MINSK
TO RUEHC/SECSTATE WASHDC 5525
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHVEN/USMISSION USOSCE 1399
RUEHBS/USEU BRUSSELS
RHMFISS/HQ USEUCOM VAIHINGEN GE
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK

C O N F I D E N T I A L SECTION 01 OF 02 MINSK 000037

SIPDIS

SIPDIS
DEPT FOR EB/ESC/IEC GALLOGLY AND GARVERICK
DOE FOR HARBERT/EKIMOFF/PISCITELLI/TILLER

E.O. 12958: DECL: 01/15/2017
TAGS: EPET PGOV PREL BO RS
SUBJECT: BELARUS BACKS OUT OF ITS OIL JAM, FOR NOW

REF: A. MINSK 013
¶B. 06 MINSK 1283

Classified By: Ambassador Karen Stewart for reason 1.4 (d).

Summary

¶1. (C) On January 12, Belarus and Russia signed an agreement on oil, giving both sides some of what they wanted. While Russia will finally see budget revenues from its oil exports to Belarusian refineries, Lukashenko has preserved, albeit in a weakened form, his country's status as an offshore destination for Russian oil firms. Minsk's readiness to break the impasse stemmed from Belarus' dwindling oil reserves and the prospect of losing 40 percent of its exports if it failed to reach a compromise with Russia. However, from oil alone, the Belarusian budget stands to face a half-billion dollar shortfall in 2007 and Lukashenko's political security remains under threat. End summary.

Russia Sticks Belarus, but It Could Have Been Worse
-- ------

¶2. (C) As a precondition for negotiations to begin in earnest, Belarus dropped its USD 45/ton duty on Russian oil transiting to Europe (ref A). Once Moscow was assured Russian oil was again flowing normally through the Druzhba pipeline, the parties began haggling over the main item on the agenda -- Russian export duties on oil. Lukashenko had publicly declared he would agree to split the duty fifty-fifty with Russia, but only one analyst to whom we spoke, Mikhail Zalesskiy, a former Belarusian Ministry of Economics official, believed this was achievable. In the end, Minsk and Moscow agreed in 2007 Russia would impose an export duty equivalent to 70 percent of Belarus' export duty, i.e. USD 53/ton (but subject to bimonthly adjustment per changes in the price of oil). This was the rate predicted last year (ref B) by Yaroslav Romanchuk, Director of the Mises Center. As a result, Russia will collect almost USD 1.1 billion in 2007 if the price of oil stays unchanged. This will hit both Russian oil companies and the Mozyr and Novopolotsk oil refineries (and thus the GOB budget).

¶3. (SBU) Earlier in 2006, before Russia announced it would begin imposing an export duty on oil for Belarus, Belarusian officials had mentioned 70 percent of Belarus' export duty as a possible compromise figure. The sides disagreed over whether the duty would be collected directly by Moscow (or by Belarusian customs with Moscow's share then transferred to the Russian treasury), and over the base export duty rate (with Russia requesting Belarus raise its export duty,

currently roughly a third of Russia's). Essentially, Moscow won on the former point, but Belarus conceded very little on the latter. The USD 53 export duty represents 70 percent of Belarus' existing duty, but only 29 percent of Russia's duty.

¶4. (SBU) The percentage will increase yearly, rising to 80 percent of Belarus' export duty in 2008 and 85 percent in ¶2009. Also, Belarus reportedly agreed not to charge Russia rent for the land under the Yamal-Europe pipeline or for Russia's two military bases in Belarus. In what could serve as a recipe for future disputes, Belarus is supposed to gradually raise its own export duties on the export of refined oil products to approximate Russian levels. If Belarus follows through, similar export duty levels would kill the incentive for Russian oil companies to export crude to Belarus.

Lukashenko's Bluster Exceeded His Oil Reserves
-- -

¶6. (C) Despite Lukashenko's statement to reporters that Belarusians could live off the land if the dispute with Russia continued, in reality Belarus would have found itself in trouble had negotiations dragged on. Beginning January 6, Belarus siphoned at least 79,000 tons of oil from the Druzhba pipeline. Tatyana Manenok, energy reporter for the weekly "Belarusy i rynok" told Econoff the decision was taken when oil reserves fell. Directors of Belarusian refineries feared the consequences of disobeying Lukashenko's orders to run at full capacity. Zalesskiy added it was not at all out of the ordinary for directors of large state firms to face jail terms if they failed to follow orders from above. According to Manenok, the original reserve of roughly two weeks (confirmed by other analysts) was depleted at over double the

normal rate due to Lukashenko's "incompetent" management.

¶7. (C) Yaroslav Romanchuk, Director of the Mises Research Center, believed Belarus' oil reserves could have lasted only until January 15. At that point Belarus would have faced domestic shortages and/or foregone the 40 percent of its exports that come from refined oil products. In addition to facing possible retribution from Lukashenko if production dropped, Zalesskiy noted the refineries would have suffered costly substantial technical difficulties if they had to go offline.

Comment: Lean Years to Bring New Challenges for Lukashenko
-- -------------

¶8. (C) Some analysts believe Lukashenko's public support has received a boost from the recent spats. Opposition leader Milinkevich estimated the dispute over gas had caused Lukashenko's popularity to rise by ten percent. Zalesskiy compared Lukashenko's behavior as that of a drunk itching for a fight.

¶9. (C) This popularity boost will be short-lived as soon as Belarusians feel the consequences of increased energy prices. From oil alone, Belarus' economy will miss out on roughly USD 500 million in expected revenue in 2007, with the amount increasing yearly; nearly as much will be lost as a result of the GOB's deal with Gazprom. Few believe the economy Lukashenko has created can deal as successfully as Ukraine has with the move to market energy prices. Poland's Charge Aleksander Wasilewski predicted wage arrears. He said Belarusians had just become accustomed to improving standards of living, and the historical lack of mobility was the only thing preventing mass emigration in the future. Wasilewski also saw a devaluation of the Belarusian ruble, currently pegged to the dollar, as a real possibility. (Note: On January 15, the Chairman of Belarus' National Bank denied a devaluation was planned for this year. End note.)

¶10. (C) Keeping the inner circle on board will be of more

immediate concern to Lukashenko than the disenfranchised man in the street. Zalesskiy told Poloff when it was claimed Belarusian oil refineries would have been unprofitable with Russia's high export duty, what was really meant was those profiting illicitly would suffer. Wasilewski added it was uncertain how the nomenklatura would react to a shrinking pie of profits. He claimed Moscow was increasingly looking for an alternative to Lukashenko, including giving support to Aleksandr Voytovich, a former President of the Belarusian Academy of Sciences who at one point had sought to run against Lukashenko and opposition coalition leader Aleksandr Milinkevich in Belarus' 2006 presidential elections.

Stewart